No. 5051

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

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CLAUDE REES, CHARLES F. HINE, REES BLOW PIPE MANUFACTURING COMPANY, INC. (a corporation), and PROGRESSIVE EVAPORATOR COMPANY, INC. (a corporation),

Defendants-Appellants,

vs.

NORMAN LOMBARD, MONTGOMERY FLYNN, WILLIAM T. ECKHOFF, NORMAN LOMBARD and ELLEN LOMBARD, Trustees for Ellen Lombard, Elizabeth Lombard and Norman Lombard, Junior,

Plaintiffs-Appellees.

BRIEF FOR PLAINTIFFS-APPELLEES.

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NATURE OF THE CASE.

This is an action in equity by one of the stockholders of a corporation (the Progressive Evaporator Co., Inc.) to set aside a transaction by which two of the directors of this corporation, one of whom was the secretary and treasurer thereof, entered into an agreement with the president of the corporation when the three of them constituted a majority of the directors of the corporation to take away the corporation's main *device) and give it to the president.*

The proof in this action established one of the most flagrant cases of the violation by corporate officers and directors of their trust that we have ever had come to our notice. Counsel for appellants naively expresses surprise at the decision. In view of the flagrant breach of trust on the part of defendants established by the evidence if the decision had been against the plaintiffs our surprise would not have been naive but indignant. The evidence conclusively established that the defendants constituting the officers and a majority of the directors of the corporation deliberately used their control thereof to take from the corporation its principal asset, to wit, the license agreement, and to give it to one of their number, Neal, the president of the corporation, for their mutual profit and advantage. It is inconceivable how any court of equity under these circumstances could have rendered any other judgment except the one given.

The Progressive Evaporator Company is a corporation organized for the purpose of manufacturing and selling a device for the dehydrating of fruit. Its board of directors consists of one of the plaintiffs, Norman Lombard, and the defendants Malcolm A. Neal, Claude Rees, Charles F. Hine and Loring Powell. Prior to November 1, 1922, Lombard was the president and Powell the secretary of this company, which we will hereafter refer to as "the corporation". This corporation's most valuable asset was an exclusive license to manufacture and sell a device for dehydrating fruit and vegetables (R. 142). This device was embraced in certain applications for patents described in the license agreement (R. 37). This license agreement was given to the corporation by Rees and Hine, the inventors and applicants for the patents, whom as we have shown were two of its directors. This agreement was dated February 10, 1922. On April 18, 1922, application Serial No. 351,538 was granted and letters patent were issued to the Rees Blowpipe Mfg. Co., as the assignee and grantee of the inventors, Claude Rees and Charles F. Hine (see Plaintiffs' Exhibit 4, R. 180). *In October, 1922, Neal, Rees and Hine, three out of five of the directors of said corporation, because of a quarrel with Lombard planned to take control of the corporation to the exclusion of Lombard and Powell and to take its license agreement away and terminate its business* (see Neal testimony, R. 254-256-390. Testimony of Hine, R. 198-200). In pursuance of this plan on November 1, 1922, they ousted Lombard and Powell as president and secretary, respectively, of the corporation and elected Neal and Hine president and secretary thereof. They then took complete control of the affairs of the corporation. They then proceeded to alter its books and records, and the books and records of the Rees Blowpipe Mfg. Co., to make it appear that the royalties due to Rees, Hine and the Rees Blowpipe Mfg. Co. under the license agreement had not been paid or secured when in truth and in fact they had been both paid and secured. [(See testimony of Powell, R. 285-287.) (Powell employed to change entries in corporation's books, see testimony of Rees, R. 246, pages of royalty account book showing destroyed, see also the royalty account book which is with the exhibits.) Also compare statements of September 5, 1922, defendants' exhibit C rendered by Rees Blowpipe Co. previous to quarrel, with its ledger account with corporation, as written after quarrel, plaintiffs' exhibit 7.] They then put a complete stop to the business of the corporation and ceased advertising, soliciting sales or doing any business whatsoever except the business of liquidating its affairs (R. 138); see Hine's testimony (R. 202), where he says:

> "Q. And, as far as the Progressive Evaporator Company is concerned, after November 1st, when you became secretary, no orders were taken?
> A. No.
> Q. And no sales were made?
> A. No."

See testimony of Neal (R. 260):

> "Q. After the row started on October 27, was any attempt made thereafter by you to carry on business for the corporation?
> A. None."

On January 13, 1923, Rees and Hine served Neal, who was acting in collusion with them, with a notice of the cancellation of the license agreement and shortly thereafter and in pursuance of their plan to take the license agreement away from the corporation they gave a new license agreement to Neal, the president of the corporation (Neal's testimony, R. 254-256; Hine's testimony, R. 198 and 218). There never was a more flagrant instance of corporate officers and directors violating their trust than the one just related. The license which they gave to Neal was similar in terms and embraced the identical patents and applications for patents and inventions covered thereby that the license held by the corporation covered.

The corporation not only held the license agreement (R. 217-218), but it also had an agreement with the Rees Blowpipe Co., dated April 17, 1922, which we will hereafter call the manufacturing agreement (see p. 64, minute book of corporation, which is an exhibit). By this agreement the Rees Blowpipe Mfg. Co. was to manufacture for certain payments the devices embraced within the license agreement when ordered by the corporation. Not only did the defendants give a new license to Neal after their attempted cancellation of the corporation's license, which license was exactly like the license held by the corporation and embraced the same devices, but the Rees Blowpipe Mfg. Co. gave to Neal an agreement to manufacture these same devices, identical in terms with the manufacturing agreement it had made with the corporation. This was all done in pursuance of the plan of these directors in control of the corporation to take its license and business away from it and turn its license and business over to the president of the corporation with whom they were acting in collusion. As soon as the new license agreement was given Neal and the new manufacturing agreement made with him and one Ward, who was his partner, doing business as the Progressive Dehydrator Co. (R. 254), *the list of customers and all of the prospects for business which the corporation had secured at great labor, expense and trouble were taken by Hine and Neal and were used by Neal to sell these patented devices under his new* fifty of them for a gross return of about $300,000.00 (R. 203-5-141). *The facts stated in this paragraph should be borne in mind when it comes to determining whether or not the record shows any evidence of manufacture and sale of these devices by the defendants.* In view of these facts the claim that there was no showing made that the defendants had manufactured and sold the patented device is ridiculous. They took the license agreement away from the corporation, gave it to Neal, made an agreement with him to manufacture for him, gave him the list of prospective customers for these devices and he went out and admittedly sold them 50 of these devices and yet it is claimed in the most naive way that there was no evidence that these devices were manufactured and sold.

Counsel for defendants were not the attorneys for the defendants in the trial court and have evidently misapprehended the real gist of this action and the real issue in the case. *It was conceded by defendants at the trial and in their pleadings that they were manufacturing and selling the patented device referred to in the patent and in the license agreement but it was claimed by defendants that this manufacture and sale did not constitute an infringement of any right of the corporation because the rights of the corporation in the patented device created* by the license had been taken away by the cancellation of this license. The plaintiff claimed that the attempted cancellation was void and that defendant had no right to cancel the license. This was the real issue in the case. This was the matter in controversy. *It was* *not denied that the patented devices were manufactured and sold by the defendants at the time of the commencement of the action. It was conceded that this was being done. It was claimed, however, that this was not an infringement of any right of the corporation. It was claimed that the corporation had forfeited all of its rights to make and sell these patented devices and that therefore the manufacture and sale of them by the defendants was no infringement. It was on this theory and on this issue that the case was tried. This the record clearly shows.*

The defendants were the officers and controlling directors of the corporation. They used their control in violation of their duties as directors and officers for the purpose of taking the corporation's main asset, this license agreement, from it, and giving it to the president of the corporation, and for the purpose of preventing the corporation from resisting the cancellation of the license and continuing with the manufacture and sale of the patented devices under this license agreement. They used their control of the corporation not only to cancel its license and prevent it from resisting this cancellation but to prevent its continuance of business and to put it out of business. As these directors were in control of the corporation and the corporation therefore was under a disability and unable to bring an action to right these wrongs being done it the right arises for a stockholder to commence an action in its behalf and to bring what is usually termed a stockholder's bill brought for the benefit of the corporation by a stockholder because the case could not bring the action.

Witten v. Dabney, 171 Cal. 621;
Federal Equity Rule, 27;
Fox v. Hale & Norcross, 108 Cal. 475, 477;
Graham v. Dubuque Mach. Co., 114 N. W. 619;
3 *Pomeroy Equity Juris.* 1095.

The acts of the defendants gave rise to a cause of action in favor of the plaintiffs, *stockholders of the said corporation, and against the defendants, irrespective of the question whether or not there was an infringement of a patent right.* The license agreement gave the corporation certain rights; these rights the defendants as officers and directors thereof were bound to protect. Instead of protecting these rights they violated them. The corporation at the instance of a stockholder was entitled to protection against such violation whether or not the violation involved the patent right and irrespective of whether the right violated was patentable or whether or not letters of patent covered the right violated. It happens that the right secured to the corporation by this license was embraced within a patent. It happens that the patentees are Rees and Hine, two of the defendants and two of the officers of the corporation violating its rights. It happens therefore that the patentees are the infringers and accordingly the licensee, to wit, the corporation, or the plaintiff, a stockholder thereof, acting for it can bring an action for infringement.

See:

Littlefield v. Perry, 21 Wall. pp. 205, 221;
Waterman v. Mackenzie, 138 U. S. 255;

Gayler v. Wilder, 10 Howard 477;
Brush Electric Co. v. California Electric Co., 52 Fed. 945.

In the case of *Littlefield v. Perry*, the court said (p. 223):

> "A mere licensee cannot sue strangers who infringe. In such case redress is obtained through or in the name of the patentee or his assignee: *Here, however, the patentee is the infringer, and as he cannot sue himself, the licensee is powerless, so far as the courts of the United States are concerned, unless he can sue in his own name.* A court of equity looks to substance rather than form. When it has jurisdiction of parties it grants the appropriate relief without regard to whether they come as plaintiff or defendant. In this case the person who should have protected the plaintiff against all infringements has become himself the infringer. He held the legal title to his patent in trust for his licensees. He has been faithless to his trust, and courts of equity are always open for the redress of such a wrong. This wrong is an infringement. Its redress involves a suit, therefore, arising under the patent laws, and of that suit the Circuit Court has jurisdiction."

So we see that defendants' violation of the license agreement which as officers of the corporation they should have protected could be prevented in a court of equity irrespective of any infringement of a patent and that the infringement of the patent is only incidentally involved but does give this court jurisdiction. Counsel for defendants has evidently overlooked this feature of this case. He is endeavoring to treat this action as the ordinary case of infringement of a patent when it involves only incidentally the infringement of a patent, and in the main is an action to prevent the themselves its valuable asset.

The main contention of defendants on appeal is that no infringement has been shown. There are three complete answers to this contention. They are the following:

1st. The manufacture and sale of the devices covered by the patent and by the license agreement *are admitted by the answer and are not denied specifically or at all by the answer.*

2nd. The case was tried on the theory stated by *counsel for defendant at the beginning of the trial, THAT THE MANUFACTURE AND SALE of the patented devices by the defendants was* CONCEDED *~~conceived~~ and that the Sole Issue was whether or not the defendants had the right to cancel the right they had given the corporation to make these devices.*

3rd. Assuming that the manufacture and sale of the patented devices by the defendants at the time of the commencement of the action are not admitted by the answer and were not conceded at the trial, *there is ample evidence in the record to support the court's decision that there had been such a manufacture and sale.* The evidence in the record establishes unequivocally the manufacture and sale of these devices by defendants at the time of the commencement of the action.

We will discuss these propositions in the order stated.

ANSWER OF DEFENDANTS ADMITS THE MANUFACTURE AND SALE OF THE PATENTED DEVICES.

First: *The pleadings admit the manufacture and sale of the patented devices.* As we have stated, the position of the defendants from the inception of this action, through the trial of this case and until they changed lawyers and took an appeal from the decision of the lower court, was that the defendants had the right to cancel the license and to make and sell the patented devices. It was claimed by them that this manufacture and sale did not constitute an infringement because the corporation by the cancellation of the license had lost all interest in the patented devices and all right to make and sell the same. *The position of the defendants in this respect is reflected in their pleadings.* Their answer does not specifically deny infringement as counsel repeatedly claims. They admit the manufacture and sale of the patented device but deny that this constituted an infringement. They deny that they manufactured or sold *in violation or infringement of any rights of the plaintiffs* (R. 78). By this form of pleading they admit that they have manufactured and sold and claim that they have the right to do so in disregard of the corporation's claims. Their pleadings in this respect are in line with and in strict accordance with the position that they adopted at the trial and have always adopted until their change of attorneys on appeal, to wit, that they had the right to manufacture and sell the patented devices covered by the patent in complete disregard of the corporation because it had lost all rights held by it under the license. In order to make this clear let us examine the pleadings. The allegation in the lation and infringement of the patent is as follows (R. 22):

> "*In violation and infringement* of the patent rights and of the letters patent covered by said license agreement in which the said corporation has an interest by virtue of said license agreement *the said Rees and Hine and the Rees Blowpipe Mfg. Co., and the defendants Neal and Ward individually and as co-partners have manufactured and sold and are now manufacturing and selling the said patented devices.*"

The answer of the defendants to this allegation is contained on page 78 of record, and is as follows:

> "These defendants deny that thereafter * * * *in violation and/or infringement of the patent rights and/or of the letters patent covered by said license agreement* said Rees and Hine and/or Rees Blowpipe Manufacturing (67) Company, Inc., and/or said defendants, Neal and Ward, individually and/or as copartners *have manufactured and/or sold and/or are now manufacturing or selling said patented devices.*"

A reading of these allegations will show that defendants *do not deny that they are manufacturing and selling the devices.* They deny that they are manufacturing or selling them *in violation or infringement of the corporation's rights but they do not deny that they are manufacturing and selling them.* There is not an unequivocal denial in their answer that they are manufacturing and selling these devices. On the contrary their answer admits the manufacture and sale, but denies that such manufacture and sale is a violation or infringement of their contract. This sort of a denial has been held to constitute an admission of the manufacture and sale and of an infringement if the validity of the patent rights are established.

The infringement of a patent is the unauthorized making, using or selling of the invention during the life of the patent. The infringement may consist in their making, using or selling the invention or in all three. See 30 *Cyc.* pp. 971 and 972, where it is said:

> "INFRINGEMENT. WHAT CONSTITUTES. IN GENERAL. The infringement of a patent is the unauthorized making, using, or selling of the invention during the life of the patent. * * * Infringement may consist either in making, using, or selling the invention, or in all three."

Infringement is the legal effect of making, using or selling an invention. The making, using or selling is the fact to be pleaded. The infringement is the conclusion. An allegation of infringement by manufacture and sale should be answered *distinctly and unevasively.* If the defendant does not deny the manufacture or sale the fact of infringement is admitted.

30 *Cyc.* 1035;

Globe Nail Co. v. Superior Nail Co., 27 Fed. 454;

Goodyear v. Day, Case #5566, 10 Fed. Cases 677;

Ely v. Monson & B. Mfg. Co., 8 Fed. Cases #4431, see first column, p. 605;

Jordan v. Wallace, 13 Fed. Cases p. 1104, Case #7523.

The last two above quoted cases and particularly the last one are directly in point. In the last case the court says:

respondents are therefore bound to answer it *distinctly and unevasively.* In their original answers, their response to this allegation is qualified and equivocal. They do not deny the use of the invention described in the patent, but only that it was used 'with a full knowledge of the premises mentioned in said bill of complaint, *and in violation of the complainant's exclusive rights secured by the patent of 1864'. This clearly implies an admission of its actual use.* * * * Thus, not only failing to deny their alleged use of the complainant's invention, which he has a right to treat as a confession of its use, *but, by their mode of answering, impliedly admitting it, the complainant is not required to make any further proof of infringement.*"

Attention is called to the fact that in the last mentioned case the denial of the defendants was practically the same as the denial in the case at bar. The defendants there denied that they were using the patented invention "in violation of the complainant's exclusive rights". In the case at bar they deny that they are manufacturing and selling *in violation of the corporation's rights.* In the case of *Jordan v. Wallace,* supra, it was held that this constituted an admission of the actual use of the patented device. Similarly in the present case the denial that they are manufacturing or selling patented devices in violation of the corporation's rights is an admission of the actual manufacture and sale of such devices. By this mode of answering, as the court says in the last mentioned decision, impliedly admitting the manufacture and sale of the device, the complainant was not required to make any further proof of the infringement. It cannot be claimed that this form of denial was a mere mistake in the pleadings. It was intentional. It was in strict accordance with the theory and position adopted by the defendants before and throughout the trial which was that they had an absolute right to manufacture and sell these devices and to ignore the corporation because they had cancelled the license which they had given it.

THE CASE WAS TRIED ON THE THEORY THAT THE MANUFACTURE AND SALE BY THE DEFENDANTS OF THE PATENTED DEVICE WAS CONCEDED.

Second: This brings us to the second proposition above stated, to wit: The case was tried on the theory that the manufacture and sale of the patented devices was conceded and the sole issue was whether or not the defendants had the right to cancel the license held by the corporation. At the inception of the trial and after the opening statement of counsel for the plaintiffs the judge requested the defendants' counsel to make a statement. The court said (R. 120):

> "MR. BARRY. Does your honor wish any statement from the defense?
>
> THE COURT. *You can make it if you want to.* I think perhaps you had better. *We want to know what the issue is that we have to try here.*"

Counsel then made a very full statement of what he expected to prove. In this statement he never at any time denied the manufacture and sale of the patented device and never by the remotest suggestion raised the question now raised by other attorneys on appeal. On the contrary at the conclusion of his opening statement counsel for the defendants stated that *the* fendants had the right to cancel the license agreement. Counsel's statement in this respect is as follows (R. 124):

> *"So that the real issue in controversy here is, first, were the royalties paid, and, second, were the royalties paid at the time that the notice of cancellation was given? It is the contention of the defendants that those royalties were not only not paid then, but that no royalty at any time had ever been paid from the time that they became due in April, 1922, up to the time that notice was given (109)."*

The right of the defendants to cancel this license agreement and take it away from the corporation and give it to the president depended upon whether the royalties had been paid or the payment thereof secured or waived. This, counsel for plaintiffs stated, *was the real issue in controversy* and thereupon the case was tried upon that theory. This statement and the entire proceedings of the defendants at the trial conclusively show that it was conceded that the defendants were manufacturing and selling the devices but it was claimed that they had a complete right to do so and were violating no rights of the corporation in doing so. One cannot try a case upon one theory in the lower court and then seek to have it reversed in the upper court on another and different theory. Having taken one position and founded their defense on one issue in the lower court and having stated to the court that that was *the real issue in the case, they cannot now, when the decision has gone against them,* turn around and claim that there was some other issue totally distinct upon which proof was not adduced. They are estopped from so doing. To allow them to do so would be to allow them to mislead the court and opponents and to later take advantage of their deception on appeal.

Counsel not only in his opening statement and throughout the trial adopted the position that there was only *one real issue in controversy* and that that was the right of the defendants to cancel the license, but in his motion to dismiss made at the conclusion of the trial, in particularizing in what respects the plaintiff had failed to establish the allegations of his complaint, *he does not by a single word claim that it had not been established that there had been any manufacture and sale of these devices.*

Furthermore, throughout the trial the court kept stating that the sole question was whether or not the defendants had the right to take the license away from the corporation. For instance:

> "The COURT. * * * *The only question is whether these defendants have wronged the corporation. If he brings in testimony enough to show that the corporation has been wronged, he will be entitled to relief, regardless of his good or bad faith.* So far as his honesty is concerned, some things may be shown. I think it will come up in your case, if at all" (R. 173).
>
> "He (Lombard) warned them that they must look out for the interest of the corporation.
>
> The COURT. *The question is did they or did they not look out for it? It would not make any difference whether they got a warning, or not"* (R. 177).
>
> "The COURT. What is the difference what Lombard was afraid of? *If you show that these people were at fault, you will get your decree, whether Lombard was afraid of them, or whether*

that goes" (R. 205).

Not once in reply to these statements of the court or at all did counsel for defendants claim there was any other issue involved. Not once did he state or claim that there had been no manufacture and sale of these evaporators. He advised the court at the beginning of the trial that there was one *real issue* involved, to wit, defendants' right to cancel the license. He presented his case on the theory that that was the only issue involved. He never advised the court that he claimed there was any other point in issue. He conceded that defendants were manufacturing and selling evaporators but claimed they had the right to do so as the corporation had lost its exclusive license.

It is a well established rule that when a case is tried on one theory, a new and different theory cannot be adopted on appeal. See 3 *C. J.* 718, where it is said:

> "One of the most important results of the rule that questions which are not raised in the court below cannot be raised in the appellate court is that a party cannot, when a cause is brought up for appellate review, assume an attitude inconsistent with that taken by him at the trial, and that the parties are restricted to the theory on which the cause was prosecuted or defended in the court below. Thus, where both parties act upon a particular theory of the cause of action, they will not be permitted to depart therefrom when the case is brought up for appellate review. *And the same is true where the parties act upon a particular theory of defense.*"

See *New York etc. Co. v. Estill,* 13 Supreme Ct. 444, where it is said in the fourth syllabus:

"Where both parties at the trial have accepted the value of the cattle at their ultimate destination as the basis upon which the damages are to be computed, defendant cannot contend on appeal that the true basis of damages was the value of the cattle as they were delivered at the terminus of its road."

See:

Bassett v. Erickson Const. Co., 213 Fed. 810.

The last mentioned case was tried in the lower court on the theory that an issue of infringement was raised by the pleading. It was held by the upper court that appellant could not claim on appeal that an infringement was admitted by the pleading. Likewise in the case at bar defendants having tried the case on the theory that the manufacture and sale was admitted but that it was not in violation or infringement of the corporation's right because it had no rights to violate, they cannot now adopt the theory that there was not a manufacture or sale by them of the patented devices. See *Lesser Cotton Co. v. St. Louis etc. Ry. Co.,* 114 Fed. 133, where the court says, page 142:

"It is evident that both parties tried the case on the theory that, if the fire was set on the roof of the barn, the defendant might be liable for it, while, if it was set within the barn, it was exempt from responsibility. The court charged the jury in accordance with this theory, and it undoubtedly made the remark that, if the fire started inside the barn, it could not have been set by sparks from the locomotive, because it was imbued with the contentions of the parties that the defendant was liable for the fire if set on the outside, and that it was not responsible for the fire if set on the inside of the barn. *It is too late for* *theory, to challenge in the appellate court* the ground upon which they sought a recovery, and to insist that the defendant was liable for a fire set within the barn, because in the trial of the real issue which they presented some testimony crept into the record, upon which they asked no instruction, and to which they do not seem to have called the attention of the court at the trial, which might have warranted a recovery on account of a fire set within the barn. *One may not try a case upon one theory, and then reverse the judgment against him in the appellate court upon another and inconsistent theory, which was not presented, urged, or tried in the court below.*"

See also:

Thomas v. Taylor, 32 Supreme Ct. 403, see p. 405; 224 U. S. 73;

Mesa Market Co. v. Crosby, 174 Fed. 96.

If there had been no manufacture and sale of these devices by defendants then there would have been no necessity for going into the question of defendants' right to cancel the corporation's license. The question of the validity of the cancellation only arose and became material when the manufacture and sale was admitted or conceded. When counsel told the court that the *only real issue was* the validity of the cancellation he conceded that the manufacture and sale had not been denied and that the question was not in issue. He made this concession at the outset and he tried his *case on that theory.* Under all the *canons* of fair dealing and under the rule set forth in the above quoted cases he cannot now change his position and adopt a new and different theory of defense.

MANUFACTURE AND SALE BY DEFENDANTS OF THE PATENTED DEVICES CONCLUSIVELY ESTABLISHED BY THE EVIDENCE.

Third. We now come to our third proposition. There is ample evidence in the record, uncontradicted and uncontroverted, establishing the fact that defendants were at the time of the commencement of the action and thereafter manufacturing and selling the patented devices, embraced within the license agreement held by the corporation. In view of the evidence it is hard for us to see how counsel has the temerity to claim that there is no proof of manufacture and sale of the patented devices by defendants. *Conceding the authorities cited by them hold all they claim they hold the evidence of manufacture and sale fulfills every requirement they claim it should fulfill.* Let us examine the record in this respect.

The issuance of the patent was alleged in the complaint (R. 5). A copy of the letters patent was attached to the complaint marked "Exhibit A" (R. 6-28-35). The issuance, genuineness and validity of this patent and of the letters patent *were not denied by the answer but were admitted.* It was not necessary therefore to introduce the letters patent in evidence as counsel seems to imply, they were already in evidence by virtue of these allegations and admissions. The letters patent were introduced in evidence however and were considered admitted by the pleadings (R. 180, Plaintiffs' Exhibit 4).

The license agreement with the corporation was made on February 10, 1922 (R. 36). It covered applications for U. S. patents No. 351,538, No. 429,298

No. 351,538 was granted in April, 1922 and U. S. letters patent No. 1,413,135 issued on this application (R. 5, 28, 30, 180). Contemporaneously with the issuance of this patent, Rees Blowpipe Mfg. Co. entered into a written agreement with the corporation to manufacture for it at certain prices the *evaporators* containing the inventions embraced in these letters patent and pending applications covered by the license agreement (see p. 64, minutes of directors of corporation, R. 138). This we will call the manufacturing agreement.

The devices containing these inventions were called *plants and evaporators.* Under the license and manufacturing agreement the corporation was the selling company and the Rees Blowpipe Co., was the manufacturing company (R. 139):

> "Mr. Erskine (Lombard's testimony): Q. You proceeded to manufacture plants, did you not?
>
> A. We were the selling organization. The Rees Blowpipe Manufacturing Company was the manufacturing concern.
>
> Q. *You gave them orders to manufacture plants?*
>
> A. *Yes.*
>
> Q. *And they manufactured plants, did they not?*
>
> A. *Yes.*"

During the year 1922 the corporation made sales of 24 of these plants or evaporators (R. 128). Now when the three directors attempted to take away the license agreement of the corporation what did they do? They gave Neal and Ward, as the Progressive

Dehydrator Co., a license agreement exactly like the one the corporation had (see allegation in complaint, not denied by answer, R. 21-22; see also R. 254-55, R. 218). This license agreement purported to give Neal and Ward the right to *make and sell the patented device* embraced within the license given to and held by the corporation. Contemporaneously with the making of this new license agreement, Rees Blow Pipe Co., made an agreement with Neal and Ward, as the Progressive Dehydrator Co., to manufacture for them these plants embracing this patented device. This manufacturing agreement was exactly like the manufacturing agreement between the corporation and the Rees Blowpipe Co. (see allegation of complaint undenied by answer, R. 22; see admission of defendants' counsel, R. 217-218):

> "Mr. Erskine. And it (referring to this new manufacturing agreement) is practically the same as the other?
> Mr. Barry. Yes."

Thus far what does the evidence show? It shows the defendants giving to Neal and Ward a license to make and sell these so-called plants or evaporators containing this patented device and it shows the Rees Blowpipe Co., agreeing in writing to manufacture these plants or evaporators for Neal and Ward, describing them by the patent number. In other words the evidence established by documentary proof that the defendants contracted to manufacture and sell the identical device described in the letters patent and in the applications for letters patent referred to in the license agreement held by the corporation and their referred specifically to the patent by its patent number and application number. These agreements in themselves identify the device to be manufactured and sold by Neal, and Ward as the same one embraced in the corporation's license agreement. These agreements and this evidence show conclusively that Neal and Ward were going to sell the same plant or evaporators theretofore made and sold by the corporation, under its license and patent rights.

Now what did Neal and Ward as the Progressive Dehydrator Company do? Did they sell any of these plant or evaporators described in their license and manufacturing agreements by exactly the same terms as the patented devices were described in the license and manufacturing agreements with the corporation? Does the evidence show they made and sold any such plants and evaporators which they had agreed to make and sell? *The evidence without conflict shows such manufacturing and selling.*

As soon as the new license and manufacturing agreement was made with the said Neal and Ward, as the Progressive Dehydrator Co., Neal and Hine took the list of prospective customers for plants of the corporation and proceeded to take orders from these customers. See Hine's testimony, R. 202, 203, 204:

> "Mr. ERSKINE. In the meantime, Mr. Hine, after this cancellation notice was given, were any orders taken by the Progressive Evaporator Company which you were the secretary or for the manufacture of any plants?
>
> A. No sir.

Q. *But orders were taken by the Progressive Dehydrator Company* (171) *thereafter, were they not?*

A. *They took some after that time.*

Q. *They took some the following year, didn't they?*

A. *Yes.* * * *

Q. During the existence of the Progressive Evaporator Company's activities, and prior to the cessation of activities around November 1st, they had secured certain prospects and lists of prospects, had they not?

A. I cannot tell you. * * *

Q. Those prospects were taken, were they not?

A. Yes.

Q. And they were afterwards turned over to Mr. Neal, were they not?

A. No, sir.

Q. He used them, didn't he?

A. No, sir (172).

Q. *And sales were made to those prospects?*

A. *Yes.*

Q. *They were?*

A. *Yes, because he went out in the field and worked among those people.* * * *

Q. But as president of the company he (Neal) knew about them, did he not?

A. Absolutely.

Q. And he made sales to them?

A. *Yes.*

Q. *And the result was that you sold 50 evaporators during the following year?*

A. I think Mr. Neal and Mr. Ward did, yes."

(R. 204.)

Here we have one of the defendants admitting that they manufactured and sold to prospective customers of the corporation, the list of whose names they had filched from its files 50 evaporators or plants. Here we have a clear unequivocal admission of the manu-

of fifty evaporators, the selling price of which was not less than $5,000.00 apiece (R. 141). How counsel can have the temerity to assert that there is no proof of manufacture and sale in view of this admission and in view of the fact that these sales were made under agreements which described the patented device by both its patent and application numbers is a mystery to us. There was never clearer proof of manufacture and sale. *There was never clearer proof that the device so manufactured or sold was the device covered by the patent claimed to have been infringed.*

There is further testimony to this same effect. Hine testified (R. 220):

> "Mr. Barry. Q. *Do you know how many evaporators were sold in 1923?*
>
> A. About 32, or somewhere along there (186)."

Defendants' own counsel brought this statement out. Neal testifies (R. 254-55) as follows:

> "A. We had a general understanding that if this agreement was cancelled that I would have the opportunity to go ahead under a new license agreement, and subsequently took the matter up with Mr. Ward, having met him accidentally in the matter in November, I believe. * * *
>
> Mr. Erskine. Q. Who was Mr. Ward?
>
> A. Mr. Ward was my partner in the Progressive Dehydrator Company *during the year 1923, and until about January 26, 1924.*
>
> Q. *And the Progressive Dehydrator Company was the company that got this license after the other one had been cancelled?*
>
> A. Yes sir."

Here he says the Progressive Dehydrator Company did business in 1923, the year the complaint was filed. Its business was the sale of the evaporators covered by the license given in the place of the one held by the corporation. *These evaporators embraced the patented device.* This itself established sales of the patented device. But Neal goes on and says (R. 260):

> "Q. *Was any attempt made by you to get business for the Progressive Dehydrator Company?*
>
> A. *Considerable* * * *
>
> Q. *Did you use the prospects which you had from the Progressive Evaporator Company's business to get business?*
>
> A. *Yes, sir.*
>
> Q. And did you tell Mr. Hine and Mr. Rees that you were doing that?
>
> A. Mr. Hine knew it; he had the letters right there on the desk, and I had access to them.
>
> Q. What letters did he have on the desk?
>
> A. Letters from various prospects.
>
> Q. Where did you get the letters?
>
> A. They were the property of the Progressive Evaporator Company for the year previous.
>
> Q. He had them on the desk?
>
> A. In the desk.
>
> Q. And you went and looked at them. Is that the fact?
>
> A. Yes, sir."

Hine's evidence alone is sufficient to establish the manufacture and sale of these patented devices. Neal's evidence alone is sufficient to establish it but there is more. *Rees and Hine kept a royalty account book of royalties due and collected by them for the use of this patented device.* This royalty account book showed the royalty due and received from the corporation in 1922 and it *showed the royalties due and received from* *pany in 1923* (see royalty A/C book, an exhibit in evidence; see testimony of Crookston, R. 356-57). Neal and Ward were paying a royalty under the new license agreement identical in terms with the one held by the corporation. This royalty covered *the use of this patented device and no other. This book shows the payment* of these royalties. The payment of royalties shows the manufacture and sale of the patented device. That is why the royalties were paid. They would not have been paid if there had not been such a manufacture and sale. *The entries in this book alone would establish conclusively if there was no other proof the manufacture and sale at the time of the commencement of this action of this patented device.* Is it any wonder that at the trial in the face of all this counsel conceded that the patented device had been manufactured and sold by defendants but claimed they had the right to do so?

Accordingly it is established without controversy by the evidence that the defendants had contracted to make and sell plants or evaporators embracing the patented device and inventions referred to in the applications for patents. In the contracts to make and sell these plants or evaporators embracing the patented invention the patented invention was described as being part of the plant or evaporator and was described by its patent and application numbers. It was shown without controversy, furthermore, that the defendants not only contracted to make and sell these plants or evaporators by agreements describing the patented devices, contained therein, by its patent number and application number, but also made actually 50 sales thereof in the year 1923. Counsel states that possibly the court may have assumed that machines were built and sold having the identical construction and mode of operation covered by the patent because of the license agreement given Neal and Ward (see p. 24, Defendants' Brief), and he says that the court had no right to make any such assumption. The court did not need to make any such assumption. Not only the license agreement but also the manufacturing agreement referring to the patented device was in evidence. Furthermore, as we have shown, there was evidence that Neal and Ward operated under these two agreements and sold the patented device therein referred to. *Furthermore, there is evidence that not only did they manufacture and sell these devices under these contracts but they paid a royalty for so doing, the royalty being the royalty due to Rees and Hine under the license agreement for the manufacture and sale of the patented device.* All this appears in the evidence and it makes the proof of manufacture and sale absolute and not dependent upon any inference or assumption. There was not only before the court the proof of the existence of a *license agreement but there was the proof of the existence of a manufacturing agreement, of actual sales and of a payment of royalties for the making and selling of the patented device.*

This is not a case where the main issue is whether or not some mechanical contrivance violates or infringes some patented device. Then the principles cited by counsel come into play. Then it is necessary defendants' brief) "the manufacture and sale of a device embodying the combination of elements defined in the patent in suit and the presence of these elements operating in the alleged infringing device according to the same mode as that of the machine embraced in the patent and accomplishing the same result". But here there was no claim or evidence that another plant or evaporator was made or sold except the one covered by both license and both manufacturing agreements and specifically describing the patent. The same plant or evaporator was contemplated by the terms of all of these agreements. The plant or evaporator was described in the same way and embraced the same United States patent described by its number and the same applications for United States patents described by their numbers. It was shown without controversy that the defendants had contracted to make and sell this patented device, that they had done so and had paid a royalty to the patentees for so doing and all further proof is unnecessary.

It would serve no good purpose and only make for the greater length of this brief to enter into a lengthy analysis of the authorities cited by counsel. We will refer briefly to them.

In the case of *Slessinger v. Buckingham,* 17 Fed. 454, the alleged sale of boots which constituted the claimed infringement was unequivocally denied by the pleadings and not admitted thereby as in the case at bar. The court says:

> "There is no *positive* testimony that these boots were made or sold by the defendant at all."

There was only the testimony of one party that he thought that a pair of patented boots had been sold but he did not know it. There was no absolute direct proof of manufacture and sale and payment of royalties on such manufacture and sale as there is in this case. There was no proof whatever of infringement.

So also in the case of *Rumford Chemical Co. v. Egg Baking Powder Co.,* 145 Fed. 953. There is no evidence whatever that the defendants made, used or sold the infringing article and the court said (p. 954):

> "*In the absence of evidence indicating that the defendant made, used, or sold the infringing article, or attached the label to the can* containing the baking powder, or was engaged in its manufacture in the Southern District of New York, I am not inclined to adopt the complainant's view that a prima facie case of infringement has been established."

Such a case is clearly distinguishable from the case at bar where the evidence establishes not only an agreement to manufacture and sell the patented device but the sale of fifty of them and the payment of royalties to the patentees on such manufacture and sale. There was no proof in the *Rumford* case. There is overwhelming proof in the case at bar.

The same may be said of *Gray v. Grinberg,* 147 Fed. 732. There the court said, page 733:

> "Admittedly, therefore, *there is no direct proof of a sale,* and the question for decision is whether the evidence fairly justifies the inference that an infringing article was sold in this city."

There was no direct proof of a sale such as there is in this case and the sole question before the court inference of such sales. The court there held that there was no evidence to justify such an inference. If there had been proof in that case as there is *here of a contract to manufacture and sell, of sales made in pursuance of that contract and of royalties paid,* then there is no question the court would have found that the evidence justified the inference that there had been a manufacture and sale.

In fact all of the cases cited by defendant are susceptible of the same broad differentiation from the case at bar. In none of them was the making and selling admitted by the pleadings. In none of them was it practically conceded at the trial that defendants were making and selling the patented device under a claim of superior right. And in none of them was there such direct proof that a machine embodying the patent device was being made and sold and royalties paid for so doing. These three propositions are a complete answer to defendants' claim that there is no showing of infringement.

DEFENDANTS CONTEND THAT THE COURT ERRED IN RESTRAINING THE INFRINGEMENT OF A PENDING APPLICATION FOR A PATENT.

In making this claim counsel shows that he has misapprehended the true nature of this action. He considers it an ordinary action for the infringement of a patent right. On the contrary it is an action by the licensee through its stockholders against the licensors and inventors to restrain them from violating their agreement giving the licensee an exclusive right to the use of these inventions.

Before the granting of a patent an inventor has a qualified property in his invention and may give an exclusive license for the use of such an invention even before it is patented.

> 30 *Cyc.* 955;
> *Brush Elec. Co. v. Cal. Electric Light Co.,* 52 Fed. 945, see p. 963;
> *Burton v. Burton Stock Car Co.,* (Mass.) 50 N. E. 1029;
> *Hendrie v. Sayles,* 98 U. S. 549.

In other words an inventor has an inchoate right which he may assign. While the inventor has no exclusive right to the invention until he obtains a patent, and while he cannot enjoin an infringement until he secures a patent, *if he gives an exclusive right by a license agreement to a third party to use that invention then that third party can restrain the inventor himself from violating the right so created by the license agreement.* The right so violated and the right to be protected by the injunction is not the statutory patent right referred to by counsel but is a right created by the license agreement. It is based upon the agreement creating the exclusive license and not upon the patent. It is the right created between the inventor and the exclusive licensee. It is separate and distinct from the patent. Neither the inventor nor the exclusive licensee can restrain others from invasion until the patent is issued because the patent is the basis of their right to restrain others *restrain invasion by the inventor himself.* This right is based upon the exclusive license irrespective of whether or not the invention is patented. It is a right arising from the agreement and not by statute. It is independent of any patent. It is analogous to the right to restrain the misuse of trade secrets (32 *Corpus Juris* 156-158). See *Simmons Medicine Co. v. Simmons,* 81 Fed. 163; the syllabus in the latter case says:

> "Sale of Right in Secret Compound.—Disclosure by Seller,—Injunction. Equity will not permit one who has sold for a valuable consideration the absolute and exclusive property in a medicine compounded by a secret process to reveal such secret to a third person, either by himself, or through a member of his family, and will restrain by injunction the use of a secret so revealed."

It is similar to the right to restrain the violation of an agreement preventing the conduct of a business in a certain territory.

See:

32 *Corpus Juris,* 223.

It is in fact the right to restrain the violation of an agreement giving an exclusive privilege. Such a right has always been upheld in equity.

See: 32 *Corpus Juris,* 223, on Injunctions, Sec. 347, where it is said:

> "CONTRACTS FOR EXCLUSIVE PRIVILEGES. Injunctions have been granted in many cases where complainant had an exclusive contract right to some privilege, to prevent such privilege from being extended to, and being enjoyed by, others."

See also:

Alpers v. City and County of S. F., 32 Fed. 503;

Singer Sewing Machine Co. v. Union Button Co., 22 Fed. Cases p. 220, Case #12,904.

In claiming that the court erred in restraining the defendants from infringing the inventions for which a patent had been applied counsel overlooked the broad equitable principle above referred to and the fact that the inventors are the licensors and the corporation, for whose benefit the action is brought, the exclusive licensee. Counsel failed to note that the defendants are violating an exclusive privilege created by their own contract with the corporation which they may be restrained from violating irrespective of whether or not a patent right is involved. This is a complete answer to defendants' contention that the court erred in restraining the violation of the exclusive right granted by the license.

IN THE STOCKHOLDERS' ACTION A COURT OF EQUITY HAS THE POWER TO AWARD THE PLAINTIFF, IF SUCCESSFUL, A REASONABLE ATTORNEY'S FEE.

In their contention that the court erred in providing in the decree for a reasonable attorney's fee to be paid the plaintiff, counsel for defendants again indicate that they have overlooked the essential nature of this action. They have considered it as mainly an action for the infringement of patent rights, whereas it is mainly a stockholder's bill to right a wrong done a corporation and only incidentally in-which that corporation has an interest. In all actions in equity brought by a stockholder on behalf of the corporation because the directors refuse to act the plaintiff, if successful, is entitled to an attorney's fee. This is the well-established rule (see *Fox v. Hale & Norcross S. M. Co.*, 108 Cal. page 477). That was an action by a stockholder on behalf of a corporation against directors guilty of malfeasance in office and the court in upholding a judgment in favor of the plaintiff for attorney's fees said:

> "He (the plaintiff) sued on behalf of the corporation to recover a fund in which others were equally interested, and the judgment in his favor was for the use and benefit of the corporation. He was, therefore, not entitled to receive the amount of the judgment himself, but clearly was entitled to an allowance out of the moneys collected of his reasonable expenses, *including counsel fees*. This right to his expenses was sufficiently shown by the allegations of the complaint, and the prayer for general relief authorized the court to make proper provision for their payment."

See:

Meeker v. Winthrop Iron Co., 17 Fed. 48.

That was an action by stockholders on behalf of the corporation because the directors and officers thereof would not act. There the court said:

> "And as the complainants have prosecuted this case for the common benefit of all the parties interested, to protect and preserve a trust fund, they are entitled to be reimbursed therefrom for all proper expenditures made or liabilities necessarily incurred in and about the prosecution of

the same. A master will, therefore, be appointed to hear proof, and take and report in reference to the accounts hereinbefore ordered, and to ascertain what will be a *proper allowance to complainants for their counsel fees and other necessary expenditures made or to be made by them in and about the prosecution of this suit*" (pages 52-53).

See also:

Graham v. Dubuque Specialty Machine Wks., 114 N. W. 619;

Trustees v. Greenough, 105 U. S. 527;

Cook on Stock and Stockholders, Sec. 48;

Forrester v. Boston Mining Co., 74 Pac. 1088.

Counsel says that the plaintiff is limited solely to the recovery of the solicitor's docket fee. He would be correct if this was an ordinary action for the infringement of a patent. But as this is an action in equity by a stockholder in favor of a corporation the rule that is set forth in the above cited cases applies and the lower court was justified in the exercise of its powers as a court of equity in making provision in the decree for the payment of the expenses of the plaintiff in this action, *including a reasonable attorney's fee.*

NEITHER REES NOR HINE NOR THE REES BLOWPIPE MFG. CO. HAD ANY RIGHT TO CANCEL THE LICENSE AGREEMENT.

Counsel devotes about ten pages of his brief to the contention that the attempted cancellation of the license agreement of the corporation was valid and that fault that the license was cancelled. The lower court heard the testimony and read the exhibits and its findings on the facts should control. Counsel lays great emphasis upon the proposition that the court in its memorandum of opinion says that the details of the evidence had escaped him at the time he wrote his decision. His opinion, however, shows that very little of importance had escaped him. The documentary proof was before him when he wrote this opinion and he had before him the transcript of the evidence and voluminous briefs written by both sides quoting the evidence, which each side claimed supported its theory of the case. So there is no basis for the claim of counsel that the court decided against his clients because it had forgotten the evidence. It had the briefs, transcript and exhibits before it and its opinion indicates that it took into consideration the salient points in the evidence.

There are several reasons why the attempted cancellation was invalid. Before stating them we will direct attention to certain equitable principles involved. First.—The right of cancellation is a *right of forfeiture.* In attempting to enforce a cancellation defendants are *enforcing a forfeiture.* The rules applicable to forfeitures, therefore, come into play. They are: (1) equity abhors a forfeiture and will seize upon slight circumstances to avoid sustaining one (21 C. J. Equity 101-103, Sec. 78). *Henderson v. Carbondale Coal & Coke Co.,* 11 Sup. Ct. 691, 694, where the court said:

"Upon this matter we observe that it is evident from the statement of facts heretofore made that the claims of the intervenors rest upon no equitable considerations, but only on the letter of the law. They do not seek to continue their contract and recover the rent, but to enforce a forfeiture; *and forfeitures are never favored. Equity always leans against them, and only decrees in their favor when there is full, clear, and strict proof of a legal right thereto.*"

See also:

Foley v. Grand Hotel Co., 121 Fed. 509, 512.

"Courts of equity will grant relief against a forfeiture which has been incurred through accident or mistake, or by reason of any fraudulent, oppressive, *or unfair conduct on the part of one who is asserting a right of forfeiture; but a chancellor will not lift his hand to aid a litigant in enforcing a forfeiture.*"

Accordingly a court of equity will seize upon any circumstances which tend to show a waiver of strict compliance with the contract and a forfeiture by the parties entitled thereto (see 21 *C. J.* page 104; *Elliott on Contracts,* Sec. 3771; *Pomeroy's Equity Jurisprudence,* 3rd Edition, Secs. 451 and 455). Almost any act by which the person entitled to declare the forfeiture recognized the continued existence of the contract or has led the defaulting party to believe that the forfeiture will not be enforced has been construed as a waiver of the right of forfeiture. Among such acts are the taking of security for the amount in default (see, 39 *Cyc.,* Vendor and Purchaser, page 1395; *Rump v. Schwartz,* 10 N. W. page 99; *Dreier v. Sherwood,* 238 Pac. 38). Once having waived the forfeiture and having led the defaulting party to believe that it would not be insisted upon it is the well-established rule that the party entitled to declare the forfeiture cannot do so *until he has given reasonable notice of his intention to do so, and has given the defaulting party a reasonable opportunity to comply with the terms of the agreement*. In other words, "He cannot use his own indulgence as a trap in which to catch the defaulting party" (39 *Cyc.* 1385).

See: Decision of Judge Rudkin in
Douglas v. Hanbury, 104 Pac. 1110;
Boone v. Templeton, 158 Cal. 297.

Applying these principles to the facts respecting the cancellation of this license we have the following reasons why the attempted cancellation was invalid:

First. Assuming that the royalties had not been paid the defendants, Rees, Hine and the Rees Blowpipe Mfg. Co., had indulged the corporation in the alleged non-payment of these royalties for nearly a year and had thus waived strict compliance with the contract at least until a reasonable notice and opportunity was given the corporation that such compliance would be required. *No such notice or opportunity was given the corporation previous to the cancellation. The cancellation notice was the first notice given by Rees and Hine of any intention to forfeit the contract.* No notice was given; no demand made; no reasonable notice or opportunity was given the corporation to prevent the cancellation of the license or to meet any demand for royalties, in fact no demand for these back royalties was made prior to the cancellation. In fact Neal testifies (R. 256) as follows:

> "Q. After the service of that notice upon you of January 12. where the license was cancelled, you took no action to prevent it, did you?
>
> A. No, sir.
>
> Q. Prior to the cancellation of the license, was any demand made upon you as president of the company for the payment of the back royalties?
>
> A. No, sir.
>
> Q. Was anything said about making such a demand?
>
> A. No. *There were times when it was said it was not wished to be made.*
>
> Q. Prior to that time of that cancellation, was any effort made that you know of to raise the money to pay these royalties?
>
> A. None that I know of.
>
> Q. None of you asked Lombard or Powell, that you know of, to agree to the use of these notes, or the use of the money in bank or the money available to take care of this royalty account?
>
> A. No" (R. 257).

The testimony of Lombard and Powell is to the same effect. Neal says here that they did not want to make any demand or give any reasonable notice or opportunity to meet the demand for the very obvious reason that their attempted cancellation might have then been forestalled. No reasonable notice or any opportunity was given Lombard or Powell, the other two directors of this corporation, or its stockholders to meet this claim for royalties, or to prevent the attempted cancellation.

bard that he and Rees would be willing to take long term notes on account of the royalties. He further more admits that he received these notes. He the states that after his quarrel with Lombard no deman was ever made for the royalties and he cancelled th contract without any previous notice. His testimon in this regard is as follows:

"Q. After this row occurred, did you ever a a Board of Directors meeting demand you royalty?
A. No, sir.
Q. You never did?
A. Not to my knowledge.
Q. Did you ever state that you were not willing—did you ever state to them after that time after the row occurred, or before, that you wer not willing to take the long-term notes?
A. No, sir.
Q. Did you ever make a written demand o the Board of Directors for the royalty that wa due you and advise them that you would cance the agreement if it was not paid?
A. I don't believe we did.
Q. And the first notice that was given th Board of Directors as far as you know, that you contemplated cancelling the contract and no accepting the long-term notes, was the notice tha was delivered to Mr. Neal at the meeting o January 13?
A. I think so.
Q. And at that time only Neal, the president and you, the secretary, and Hine were present
A. And Mr. Rees.
Q. Yes, I mean Mr. Rees.
A. Yes" (R. 191-192).

Accordingly it is established that the attempted cancellation was absolutely void because there was no compliance with the well-known equitable rule requiring a reasonable notice and opportunity to perform. This is the first reason why the attempted cancellation was invalid. There are others just as strong.

Second. Hine and Rees and the Rees Blowpipe Mfg. Co. accepted collateral as security for the payment of these royalties. This, under the well-established equitable rules, in itself constituted a waiver of forfeiture at least until the security accepted was exhausted. The method of doing business on the part of the corporation was as follows: it would get a contract for the purchase from it of one of these devices. The contract would require the purchase moneys to be paid in installments, which installments were evidenced by notes of such purchasers. When this order was obtained the corporation would place an order with the Rees Blowpipe Mfg. Co., to manufacture the patented device referred to in the contract. The Rees Blowpipe Mfg. Co. would manufacture that device and deliver it to the purchaser and charge the corporation with the cost thereof as agreed in the manufacturing agreement. The defendants, Rees and Hine, were the two stockholders of the Rees Blowpipe Mfg. Co. They were also the real owners of the patent which stood in the name of the Rees Blowpipe Mfg. Co. From time to time the Rees Blowpipe Mfg. Co. would render statements of the moneys due it from the corporation. These statements are in evidence (Defts. Ex. C). Included in them was one dated, September 5, 1922. Included in these statements up to and including September 5th were not only the moneys due for the manufacturing but also the moneys due for royalties under the license agreement (see Defts. Ex. C). From time to time the corporation would pay to the Rees Blowpipe Mfg. Co. sums of money in payment of the amount shown to be due by these statements and would deliver to them certain notes or contracts obtained from the purchasers of these devices. These notes were credited as payment just the same as cash as far as any notes delivered prior to September 5, 1922. The statement of September 5th, shows total debits for manufacturing costs and *royalties* of $50,769.59 and credits for cash and notes accepted as cash of $29,863.88, leaving on that date a balance due, including royalties, of $20,905.71. After this statement of September 5th was rendered showing that $20,905.71 was the balance due *including royalties* a so-called "big batch of notes" were delivered to Rees and Hine by the corporation (see Defts. Ex. J; see "notes discountable account" in ledger of the corporation). The face value of these notes amounted to $24,875.00 (see notes discountable account). The evidence shows that $8150.00 of these notes, to wit, the Kooser, Stevens and Turner notes were taken and applied by Rees and Hine to the royalties then due them (Rees testimony, R. 247; Neal, R. 259. Notes discountable accounts show these notes had face value of $8150.00). Lombard and Powell claimed that these notes were taken in payment of the royalties while Rees and Hine claimed subsequently that they were merely taken as security. But the fact remains that on the date of the attempted cancellation of the license Rees and Hine had accepted and held notes of the third persons endorsed by the corporation *either in payment of the royalties due under the license agreement or else as security for their payment.* The receipt of these notes and the application to the royalty due had been entered in a royalty account book kept by Rees and Hine. This royalty account is in evidence in the action. It is marked on the fly-page thereof "C. Rees and C. F. Hine royalty account". Realizing that the entry of the receipt of these notes as payment on account of the royalties and their application to the royalty account and their entry as such in this book made it impossible for them to claim that the corporation had not complied with its license agreement, the defendants Rees and Hine destroyed the pages in this book containing these accounts. But Neal, the president, of the corporation and the one to whom the new license was given, testified that the defendant Hine had admitted to him that he realized that in view of these entries in this book they had no right to cancel the license agreement which they attempted to do (R. 279).

Accordingly we find that the evidence clearly shows that the royalties due under the license had been paid in part and the payment of the balance thereof had been amply secured. The security of $24,875.00 was $4000.00 in excess of the total amount due for manufacturing and royalties. As Rees and Hine and the Rees Blowpipe Co. *had received and accepted security for this indebtedness* they waived any right which they may have had to cancel and forfeit this license for non-payment, at least until they had exhausted reasonable notice and opportunity to meet their demands. For this reason alone therefore the cancellation of the license was invalid.

Hine testified (R. 190) as follows:

"A. At one time we were discussing taking these notes over for the accounts, and the point at issue about the patents was brought up in this way, that if Mr. Lombard could not raise money and pay us, that if the worse came to the worst, as I put it *once before, we would take the long-term notes as payment on the royalties.*

Q. Take the long-term notes, the notes of the Progressive Evaporator Company?

A. Yes, a part of those notes that were under discussion.

Q. You refer to notes which purchasers had given the Progressive Evaporator Company, do you?

A. Yes.

Q. And did you state that you were willing to take those long-term notes on account of the royalties?

A. At one time we did, yes."

(R. 194):

"Q. You did make some division of certain notes that you had?

A. Yes, sir.

Q. What were those notes?

A. I cannot tell you.

Q. And you made a division of them on account of royalties, did you not?

A. *Yes, because he had that discussion with Mr. Lombard previous to that time.*

Q. Did you make any division of cash received on account of royalties?

A. No, sir.

Q. You just made the division of the notes?

A. Yes, after that discussion."

In other words he admits that he agreed to take long-term notes in payment of royalties and that he actually took these notes after this discussion with Lombard and applied them to the royalties. According to his own admission therefore the royalties were paid. According to his own admission he had waived a forfeiture by indulging the debtor and taking notes in payment. This was done by agreement with Lombard when Lombard was president of the corporation. Accordingly under the rules of equity adopted to prevent forfeitures the defendants had no right to declare this forfeiture as they had been paid by the receipt of these notes and the application thereof to royalties. It is no wonder that Hine told Neal that in view of the entries in the royalty account book showing payment of these royalties he doubted if they could cancel the license (R. 179). It is no wonder that when the case came on for trial those records in this account book had been destroyed. Not only had the records in the account book been destroyed but Powell had been employed to alter the books of the corporation which were then in the possession of the defendants and the statements rendered after September 5, 1922, by the bookkeeper were changed in an attempt to show that the moneys therefore received and credited on royalties had not been so applied.

Third. Counsel claims that the court erred in holding that the attempted notice of cancellation was ineffective because not signed by the Rees Blowpipe Mfg. Co. This was only one of the grounds which made the attempted cancellation ineffective. The others, above given, are much more substantial and support the finding that the attempted cancellation of the license was void irrespective of whether or not the notice of cancellation should have been signed by the Rees Blowpipe Co. The fact that the notice of cancellation was not signed by the Rees Blowpipe Co., made the notice ineffective. It is true that Rees and Hine were the licensors. When they made this license no patents had been granted but on April 18, 1922, a patent was granted not to them but to their assignee, the Rees Blowpipe Mfg. Co., and thereafter the Rees Blowpipe Mfg. Co., with their knowledge and consent and through them rendered bills to the corporation for royalties up to and including the statement of September 5, 1922. This indicated that certain of the rights of Rees and Hine under the license agreement had been transferred to the Rees Blowpipe Mfg. Co., and that it was not only the holder of the bare legal title to the patent but also had some beneficial interest in the license agreement. There is no evidence that this interest of the Rees Blowpipe Mfg. Co. in this contract was merely that of trustee and of the bare legal title. There is no evidence that even if it was merely a trustee or holder of the bare legal title that knowledge of this fact was given the corporation. There is evidence that it rendered bills, through Rees and Hine and with their knowledge, for the royalties due under the license agreement. It clearly therefore had become, after the execution of the agreement by assignment from Rees and Hine, a party to the license agreement and interested therein. It was, therefore, a necessary party to any notice of cancellation of the agreement.

In the case of *Henderson v. Carbondale Coal & Coke Co.*, 11 Supreme Ct. Rep. 691, above quoted, it was claimed that a contract had been cancelled. The contract required that notice of cancellation must be given personally. It was given by registered mail and the receipt produced in court but it was held that this was not sufficient. *It was held that one attempting a forfeiture must strictly comply with every step necessary to effectuate it.* Equity will seize upon any circumstance to prevent a forfeiture. Certainly under this rule the failure of one of the persons interested in the license agreement to declare it forfeited rendered the cancellation ineffective.

Counsel attempts to place the blame for the loss of the license on Lombard. Lombard was the holder of about forty-five per cent of the capital stock of the corporation. Counsel makes the gratuitous misstatement that Lombard contributed nothing to the assets of the corporation. There is absolutely nothing in the record in support of this statement. Lombard was the leading spirit in the organization of the corporation. He was the person that secured for it the exclusive license which was its most valuable asset. He devoted all of his time to the building up of its business so that in the first year of its operations it sold 24 plants (R. 128), the prices of which ranged from five to fifteen thousand dollars each (R. 141). This statement that Lombard contributed nothing to the assets of this corporation is a mere canard invented by the defendants to excuse their flagrant violation of their duties as officers and directors of this corporation.

At this point let us refer to another gratuitous misstatement in counsel's brief about Lombard. He states that the corporation did not prosper on account of the failure of Lombard. There is no evidence that the corporation did not prosper through the failure of Lombard. The corporation was prospering. In the first year of its business it was making a substantial profit. It was for this reason that Neal, Hine and Rees wanted to secure the license and get the business themselves. There is not a statement in the record which substantiates counsel's claim that the business was a failure or that the failure was caused by Lombard. Counsel says that Lombard should have seen that the royalties were paid. Lombard was president up to November 1, 1922. The license was cancelled on January 13, 1923. Neal and Hine were president and secretary from November 1, 1922, to January 13, 1923. Lombard therefore was in no position after November 1, 1922, to direct the application of payments. Moreover, prior to his ouster as president, he had directed the application of these payments to royalties. This is indicated by the destroyed royalty account of Rees and Hine and by the statements to and including September 5, 1922 (Defts. Ex. C), which were rendered before Rees, Neal and Hine made their plan to get away the license and business of the corporation. Lombard did just what counsel says he should have done. He saw to it that the royalties were taken care of. *He obtained an agreement from Rees and Hine to take* *long-term notes in payment of royalties* (see Hine's testimony, R. 190). He secured and gave them these long-term notes. He had statements from them showing the application of these notes to royalties and his books and their books, prior to the changes made by the defendants in an attempt to carry out their plan to loot the corporation, showed that these royalties had been paid and secured. It was necessary, therefore, for the defendants to change the books as they did.

Moreover as the lower court points out any dereliction on the part of Lombard would be no excuse for the violation by the defendants of their trusts. They were the officers and directors of this corporation from November 1, 1922, up to the date of the cancellation and thereafter. Upon becoming such officers and directors a duty devolved upon them to do their utmost for the protection of the interests of the corporation.

See: *Geddes v. Anaconda Copper*, 41 Sup. Ct. 212, where it is said:

> "The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common *members are regarded as jealously by the law as are personal dealings between a director and his corporation, and where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness and where a sale is involved the full adequacy of the consideration.* Especially is this true where a common director is dominating in influence or in character. This court has been consistently emphatic in the application of this rule, which, it has declared, is

tiffs as stockholders bring this suit on behalf of th corporation to right those wrongs. A stockholde whether he owns one share of stock or one thousan shares, has this right. The mere fact that the stock holder bringing an action of this character may him self have been guilty of some wrong to the corpora tion, is no defense to an action brought by him o behalf of the corporation and is no excuse for th dereliction in duty of the defendants. An action o this character brought by a stockholder is brough by him in a representative capacity and not person ally and his personal acts have no bearing on th situation.

See:

Witten v. Dabney, 171 Cal. 621.

CONCLUSION.

We respectfully submit that the decision of th lower court should be affirmed on the followin grounds:

First: That the attempted cancellation of th license agreement was void

(1) because defendants had waived the right t cancel it,

(a) by accepting security for the payment of th royalties, and

(b) by agreeing to and taking long-term notes o third persons in payment of the royalties, and

(2) because prompt payment of royalties had never been insisted upon and strict compliance with the contract therefore could not be demanded without reasonable notice and an opportunity to perform which was never given, and

(3) because the license was cancelled in pursuance of an illegal agreement of the officers and controlling directors of a corporation to cancel the license and give it to one of their number, the president.

Second: That the defendants after cancelling the license of the corporation and stopping its business proceeded to manufacture and sell the same evaporators embodying the patented device in violation of the trust they bore the corporation and in violation of the license agreement. This manufacture and sale was admitted by the pleading; was conceded at the trial and was established by the evidence in many ways including the record of the payment and the receipt of royalties for the use of the patented device in the plants so manufactured and sold.

Dated, San Francisco,
May 26, 1927.

Respectfully submitted,

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